1937

Economic Conditions
Governmental Finance
United States Securities

New York, February, 1937

General Business Conditions

THE labor troubles in the automobile industry and the floods in the Ohio River basin have naturally overshadowed other news of the business situation during January. In these respects the month has been unfavorable, and in the speculative markets sentiment shows some unsettlement. On the other hand, trade and industrial reports continue excellent, allowing for these handicaps. The slowing up is confined to the areas affected, and otherwise the detailed business news gives satisfaction. Merchants continue to prepare for a good Spring season, manufacturers are busy with full order books, and both are looking ahead with confidence moderated only by the uncertainties in the labor situation.

The floods which have caused such devastation and suffering in the Ohio Valley have of course brought many business activities to a standstill. However, the rebound following the widespread floods in March of last year supplies a precedent for believing that the interruption will be brief. Floods are very spectacular, and for that reason early estimates of the damage usually prove to be exaggerated. In various ways, through relief contributions, insurance, use of corporate reserve funds and recourse to borrowing, losses of wealth due to natural calamities are spread out and part of the costs carried over to the future, to make them less burdensome on the immediate situation. Meanwhile the work of reconstruction is to be done, requiring labor and supplies, and probably this is where the emphasis belongs for the early future.

Retail trade has been held back also in sections affected by strikes and bad weather, but elsewhere gains over last year have run into good percentages, and the figures on balance are satisfactory. There is evidence that on the average merchants are looking for an increase in Spring trade of around 10 per cent over 1936. Wholesale business is off to an exceptional start. More buyers are in the markets than since 1929, and they are placing more orders and at higher prices than a year ago; in some cases covering of Fall requirements has begun, considerably in advance of the usual buying season.

Manufacturers also have been buying materials farther ahead than in a long time. In all lines buying policies are influenced not only by increasing sales and the signs of an upward price trend, but because in many industries the prompt deliveries made during the depression are no longer feasible, and it is necessary to place orders for longer terms. Also, no one can assume too confidently that labor difficulties will not interfere with shipments.

Industrial Output Above 1929 Average

As the trade reports suggest, in most industries operations hold at the high December rate and unfilled orders are large. The volume of industrial production in December, according to the Federal Reserve Board's index, which was 121 (1923-25 = 100), was higher than the monthly average for 1929, though not equal to the peak month of that year. The indexes for January will doubtless be lower, judging by preliminary figures, but the recession is limited almost wholly to the automobile and allied lines, and to flood interruptions. Railway car loadings and electric power consumption, while reduced in the Ohio Valley, show well-sustained gains over last year. Steel and textiles, with order books filled, have carried on operations at the highest rate of the recovery, except for a few steel mills in flooded areas.

Steel ingot output has run during most of the month above 80 per cent of capacity. The steel producers in 1936 sold 20 per cent of their output to automobile manufacturers, and of course shipments of automobile steel have dropped off considerably. However, mills have a large backlog of orders from other sources, and new business has been better than was generally expected, in view of the forward buying that took place toward the end of 1936. Steel men see little evidence that abnormal stocks are being accumulated, and expect production to hold at the current rate for some

time unless the automobile troubles are prolonged.

Building contracts awarded during the first half of January showed an unseasonal increase over December, and the Dodge Corporation's statisticians estimate that a 25 per cent increase in total building in 1937, despite a falling off in publicly-financed construction, is a conservative expectation. Orders for machine tools have broken all records, with December one-third larger than the peak month in 1929. The volume of business on hand and in sight for the rail and utility equipment industries, which are still the laggards in the recovery, is the best since pre-depression years, and their improved outlook has been so generally stressed in all analyses of the business situation that it is a great encouragement to confidence and enterprise.

Recovery Under Strong Headway

Reports of this character, continuing one month after another, naturally generate optimism. They show that the recovery is going ahead under a strong momentum and that the natural trend is in the direction of increasing production, giving work to the unemployed, making business self-supporting, and re-establishing the fullest practicable activity of the economic system. Moreover, the great advance within a single year, as measured by the business statistics, employment and payroll figures, and corporate reports for 1936 published during the past month, shows how greatly all groups in the economic system stand to gain by giving their cooperation to keep the upswing going. The index of employment in December, compiled by the Department of Labor, was less than 2 per cent below the same month in 1929, and payrolls were less than 6 per cent smaller. This represents an increase in the real income of labor, since the cost of living is around 15 per cent lower. The earnings of 215 large industrial corporations which have thus far reported for 1936, while still averaging much below 1929, were 74 per cent greater than in 1935.

Business has come a long way from the disorder and paralysis which threatened almost to destroy it only a few years ago, and as far as the volume of production goes is back to the so-called normal, according to various indexes. But this in no way signifies that the improvement has any natural or fixed limit. The objective of the recovery will not be attained until the workers and productive facilities of the country are again fully employed; and the paramount problem is to keep the upswing going, free of obstruction, to reach that goal. As long as all elements in the industries and trades work and cooperate together, and none upsets the equilibrium by seeking advantage at the expense of others, there is no assignable limit to the growth of business and the advance in the general welfare.

This statement will bear repetition and emphasis in every possible way. The business improvement is proceeding under the driving force of unsatisfied wants and the desire of business men to do business; the forward movement is cumulative; and the momentum will carry it on as long as the progress is orderly and the equilibrium is maintained. The rise in trade shows that the economic system is in better working order, with costs, prices and incomes of the various elements of the population all in better balance than for many years, promoting production and the exchange of goods. The great need now is to keep the situation on an even keel, avoid conflicts and disturbances, and allow free play to the economic factors which keep the system in balance and drive the recovery ahead.

The Automobile Labor Troubles

The chief threat of disturbance to the recovery now is through labor troubles stopping production and raising costs. The strike against the General Motors Corporation is itself important enough to check the business upswing, in view of the Corporation's leading position in one of the key industries in the recovery. No other corporation in this country is directly responsible for so much employment, counting its own payrolls and those of its dealers, and no other buys such vast quantities of materials, parts and supplies of all kinds, from such widespread sources. It is a grave matter to have a business of this magnitude suspended. If the activities of the Corporation are long paralyzed at its center, which is the assembly of finished automobiles, the effects will be felt, directly and indirectly, in all industries and all sections.

All automobile producers were working against a heavy backlog of unfilled retail orders at the end of 1936, and had not yet made a start toward stocking their dealers for the Spring selling season. Production schedules for January called for output close to capacity, to catch up with orders and lay in stocks, but General Motors in the latter part of the month had to suspend assemblies almost entirely, and other producers have been hampered by shortage of glass and sporadic labor troubles among their suppliers. Total assemblies in the industry were down by the end of January to 75,000 weekly or thereabouts, compared with schedules which would have called for perhaps 125,000 if conditions permitted. The strike against the glass producers has been settled, which will soon relieve the glass shortage, but as long as General Motors is practically down total automobile production will be curtailed by 30 to 40 per cent.

Unless the situation is soon relieved, there evidently will be a shortage of cars in dealers'

hands during the peak selling season, and deliveries may be delayed to the extent that some of this season's sales will be carried into the next model year. The automobile industry has expected to sell well over 5,000,000 vehicles in 1937, and with good reason considering the advance orders, but this expectation may have to be shaded.

Moreover, the strike reduces the purchasing power of everyone who loses employment or business by it, and the loss cannot be recovered until the lost production is made up. The industry is one of the principal employers of labor in this country, with an estimated 400,000 workers on the rolls of the automobile companies, and many more making tires, parts and other materials going into cars.

It is a noteworthy fact that the automobile manufacturers are employing more workers per car produced than in 1929, despite new labor-saving methods; the explanation is in the refinements and improvements continually introduced in new cars. Moreover, automobile labor receives the highest weekly wages and the second highest hourly wages among the twenty-five principal manufacturing industries in the country, according to calculations of the National Industrial Conference Board for November, 1936.

The purchasing power of automobile labor is therefore considerably above the general average of the population. Even a temporary loss of employment by a substantial body of General Motors workers is matter for concern. Shareholders too are incurring a loss, due to idle plant and increased costs, and their loss is a permanent one. The automobile industry itself will suffer from the reduced buying power, and other industries also.

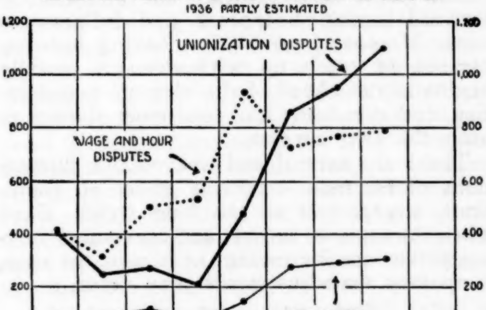
Problems of the Current Strikes

The uncertainties in the labor situation apply not only to the automobile industry, for there are apprehensions that the troubles may spread. It is plain that the application of the "sit down" technique—which may be defined as picketing inside the plant—has made it much easier to bring strikes about; and it has made strikes of comparatively small numbers of workers much more effective in stopping production. Therefore it has become possible for a minority of employes to disrupt the operations of any manufacturing industry, and especially those employing progressive assembly methods. The essence of the progressive assembly is that the movement of parts to the assembly line and the labor of each man on it are synchronized; and if the supply of one part is stopped or one man fails to do his task the assembly of the finished product is interrupted. If the worker sits down in his place and prevents another from filling it the interruption is complete.

Clearly the "sit down" strike is a weapon which may be employed by such small groups of workers, and with such ease, that it vastly increases the area of possible labor disturbance. It is difficult to combat, even where the great majority of workers want to keep at work. Moreover, lasting settlements of disputes are difficult to reach, since irreconcilable minorities have such an easy method of continuing their protest. Professor Leo Wolman of Columbia University, an authority of high standing on labor relations and former chairman of the Automobile Labor Board, has commented on the tendency of the method to get "out of the control of its practitioners and of the unions which sanction it"; also upon the incitement to conflict and violence that it creates within the ranks of labor, in cases where a minority deprives a majority which wants to work of the opportunity to do so.

It is also obvious that the "sit down" is particularly an effective weapon for unions which have in their membership only a minority of the workers in an industry or corporation, and which are endeavoring to increase their enrollment and enlarge their power. The General Motors strike, like the majority of labor disputes during the past two years, has arisen not over wages or working conditions, but upon the issue of the recognition of a specific union as the agency for collective bargaining. The U. S. Department of Labor compiles totals of labor disputes each month, and classifies them according to the principal causes, and the accompanying chart shows the rise of union recognition as the major question in dispute. In

NUMBER AND PRINCIPAL CAUSES OF INDUSTRIAL DISPUTES
1936 PARTLY ESTIMATED



1933 strikes over wages and hours were still the most numerous, but since then they have diminished, while those originating in demands for recognition have continuously increased.

This chart should dispose of the argument that strikes are essentially the "growing pains" of recovery, and that their increasing number reflects only the normal desire of labor to advance its wage rates with every rise in corporate earnings and the cost of living. If this were the reason for the increase in

strikes in past recoveries, and in the first year of this one, it plainly does not apply at the present time. Wage rates have advanced more rapidly than living costs, and as stated earlier, labor's real income, even for shorter hours of work, has risen above the pre-depression level. The issues in the present disputes are complex, labor politics is involved, and no one can yet foretell the outcome.

Warnings Against a Reaction

Apart from apprehensions that strikes may spread, there is another important question as to the business prospect, namely, whether the upswing has moved so rapidly as to invite a natural reaction. January is the bank meeting month in this country, and in their addresses a number of bank chairmen have considered it appropriate, for the first time in eight years, to warn against the excesses of a boom. Also, the Federal Reserve authorities are giving study to means of exercising control, when necessary, over imprudent speculation and unwise credit expansion. Of course the question will be disposed of by the business situation itself if labor disputes spread very widely.

In due course all vigorous upward movements of business run into reactions. During the rise buying tends at first to run ahead of production, under the stimulus of increasing consumption, inventory replenishment, forward covering, fear of delivery troubles, anticipation of rising costs and prices, and purely psychological influences. Eventually the crest of the move is reached, and there are always people who buy only for the rise and turn sellers as it slows down. The incentive to forward buying disappears, and dullness ensues. Moreover, production, having been increased to catch up with demand, usually begins to run ahead of the ultimate consumption, and eventually the pace must slacken to keep the two abreast.

These are normal and unavoidable fluctuations of business, occurring under all conditions, irrespective of the long trend. Even when the national income and consumers' buying power are increasing, as is now the case, temporary maladjustments may occur.

The Present Situation

In the present situation forward buying has reached boom proportions in a few of the industries, notably textiles, and a few of the commodity markets. However, there is no evidence that stocks are accumulating to any threatening extent, or that a general reaction is imminent. Even in cotton goods, although production has been running at all time high records and mills are sold up for several months ahead, sales in some constructions during the past month have again exceeded output, and premiums are still obtainable for spot goods. This is virtual proof that inventories are still low, and it seems to put the normal reaction some time ahead. The same conclusion should apply to industrial activity in general.

Moreover, the possibility of normal adjustments in business activity need cause no apprehension, provided the preceding upswing has not been excessive. As long as confidence is maintained, and the equilibrium is not upset by too rapid rises in costs and prices, labor conflicts, or disturbances outside the economic system, such reactions may be expected to run their course in an orderly and expeditious manner. They are in fact necessary to keep business in balance. The evidence is that at present incomes are rising more rapidly than living costs, although there is some doubt as to what may happen later when the increases in raw material prices and wages, and the social security imposts, are fully reflected in retail prices.

While many experienced business men consider that a slackening of the recovery pace in consumer goods industries will be in order some time during 1937, it is unquestionable that the trend in the capital goods industries is upward, and that in them no reaction need be apprehended. The improvement in these lines adds to consumer purchasing power. It gives the recovery movement a sounder foundation than it has had in any other year.

The Commodity Markets

Forward buying of commodities is a practice which is readily carried to excess, particularly when accompanied by uninformed public speculation, and the sharp rise in staple commodity prices since the first of November has been viewed in some quarters as a danger, on the ground that it is greater than justified and that the reaction will bring costly losses. There is reason for caution after an average rise in staple raw materials of around 15 per cent in less than three months, and since the middle of January the advance has leveled out. Markets in which public trading has been unusually heavy, such as cocoa, have had a considerable reaction.

The rise has been world wide in scope and due in general to increased consumption, forward buying both for commercial and armament purposes, and the decrease in stocks due to reduced production in the depression years. It has been most marked in the metals, rubber, wool and cocoa. Production of rubber and some of the metals is controlled by international agreements; and the operation of the controls has not proved flexible enough to provide increased supplies as rapidly as demand expanded. Hence a temporary scarcity has developed. However, steps have been taken to increase supplies. Allowable rubber

shipments have been raised, and restrictions on copper production outside the United States have been temporarily abandoned.

If rubber growers ship their quotas, stocks should be on the rise again in a few months, and the present price is an inducement to production. Copper consumption should gain substantially this year, in view of the uptrend in equipment, construction and armament industries; however, output will rise considerably also, since the price of 13 cents is profitable even to the higher cost mines.

The wool situation is decidedly strong; the only question is how greatly the advance to $1.14 for clean territory wool in Boston has discounted the scarcity, and will lead to substitution of cheaper fibers.

The prospect is for a substantial increase in farm production in 1937, especially grains, and the Department of Agriculture is encouraging it.

All these are influences suggesting that the commodity advance should level off. However, the markets have support in the high rate of business activity and the increasing consumption, together with factors tending to raise costs.

Money and Banking

The money market has been in a state of expectancy all month, due to recent pointed warnings of possible increases of member bank reserve requirements. Already the period of uncertainty has run on longer than had been anticipated, and the suspense of waiting has tended to heighten the "jittery" feeling of the market.

Reflecting these influences, interest rates have firmed slightly, particularly for investments of short-term, high liquidity class, the yields of which have been down almost to nothing. The average discount basis of weekly Treasury bill issues, after some increase in December, rose further during January to 0.361 per cent for 9-months maturities, compared with 0.084 per cent at the beginning of December. Corresponding with these advances in the yield of Government paper, bankers' acceptance rates were marked up 1/16 to 1/8 of 1 per cent, depending on maturities, to a range of 5/16 bid-1/4 asked for maturities up to 90 days, with a slightly higher range for the more distant dates. While stock market call and time loan rates were unchanged, there was considerable shifting by brokers from call to time money.

Prices of United States Government and other high grade bonds were strong early in the month, in some cases reaching new high levels, but reacted sharply following the advance in yields on Treasury bills and bankers' acceptances.

In the following table, we give a comparison of short-term open market rates at the close of January and at the cyclical low points:

Short-term Interest Rates, End of January And at Depression Lows

	End of January	Depression Low	
Call Money	1 %	¼%	(Apr. - Oct., 1935)
Time Money, 60-90 days	1¼	¼	(Apr. - Oct., 1935)
" " 4-6 months	1¼	¼	(May - Oct., 1935)
Commercial Paper, Prime 3-6 months	¾	¾	(Aug., 1935 to date)
Bankers' Acceptances 90 days, asked	¼	⅛	(Oct. '34 - July '36)
Treasury Bills, 9 months	0.361	0.052	(July 17, 1935)

As will be seen, rates generally have risen somewhat from the bottom. While the rise has been small, nevertheless, coming in conjunction with the expansion of business and the greater disposition of the authorities to control excess reserves, it has been regarded as having considerable significance from the standpoint of trend. On the theory that these advances point towards an improvement in bank earnings, bank share prices enjoyed a substantial rise during the month.

Outlook for Money Rates

That short-term money rates are due for some advance from the extreme low points in case reserve requirements are raised does not appear improbable; but that the advance will carry far at this time appears unlikely. As pointed out in previous issues of this Letter, even if reserve requirements are raised the limit permitted by law (33⅓ per cent above the present levels), the member banks will still have well over $500,000,000 of reserve in excess of legal needs. During recent years we have become so accustomed to seeing excess reserves running into the billions that this may seem like a small total in comparison. As a matter of fact, it is a very large total, measured by any other standards than those of the past three years. As the reader will perceive upon examination of the next table, the decline in short-term interest rates had largely run its course by the time excess reserves had reached $500,000,000 on the way up, and all the hundreds of millions added to excess reserves since have had little effect on rates already so low that they could hardly go much lower.

It is true that long-term interest rates, as represented by bond yields, have continued to decline and are now substantially lower than they were three years ago. The movement of long-term interest rates, however, is naturally a slower process than that of short-term rates, and it is not clear that the bond market might not have gone equally high with excess reserves at lower levels.

Distribution of excess reserves is, of course, important, and was made the subject of comment in the January issue of the Federal Reserve Bulletin. These figures are interesting

Excess Bank Reserves, after Deduction of Rediscounts with Federal Reserve Banks, Compared with Money Rates
(In Millions of Dollars)

Date		Excess Reserves*	Commercial Paper**	Bankers' Acceptances
1929	June	$— 930	6	5½
1930	June	— 168	3½–3¾	2
1931	June	— 56	2	⅞
1932	June	— 338	2¾–3	⅞
1933	Jan.	331	1¼–1½	⅜
	Apr.	— 148	3	1¾
	July	211	1½–1¾	⅜
	Oct.	136	1¼–1½	¼
1934	Jan.	721	1¼–1½	½
	Apr.	1,385	1 –1¼	¼
	July	1,608	¾–1	3/16
	Oct.	1,676	¾–1	3/16
1935	Jan.	1,795	¾–1	⅛
	Apr.	1,815	¾–1	⅛
	July	2,312	¾–1	⅛
	Oct.	2,590	¾	⅛
1936	Jan.	2,845	¾	⅛
	Apr.	2,303	¾	⅛
	July	2,666	¾	⅛
	Oct.	1,942	¾	3/16
1937	Jan.	2,007	¾	3/16

* After deduction of rediscounts with Federal Reserve Banks.
** Open market.

in view of the prevalent impression that the excess reserves are concentrated largely in the central reserve cities of New York and Chicago. The Bulletin study, which covers the latter part of November, shows this not to be the case. Actually, for the period examined, banks in the reserve cities held reserves 50 per cent in excess of requirements, while the so-called country banks had reserves 70 per cent above requirements. For the Chicago banks, the "excess" amounted to 52 per cent, while the New York City banks, with reserves about 40 per cent above requirements, had the smallest percentage of excess reserves of any class of banks. In other words, from the standpoint of location of excess reserves, an advance of reserve requirements would seem to present no serious problems, though some readjustment of position would doubtless be necessary in individual cases.

It should be borne in mind, also, that an advance of reserve requirements has the effect not only of reducing the excess reserves, but also of diminishing the deposit expansion possible on the basis of those that remain. Already this ratio has been cut down by the higher reserve requirements put into operation last Summer, and if the reserve requirements are raised again the ratio will be cut down still further. That is to say, under higher reserve requirements, excess reserves of, say $500,000,000, will not mean the same thing in the way of potential credit expansion that they meant when excess reserves were last $500,000,000. With reserve requirements raised the limit, the ratio of potential credit expansion would be in the proportion of $5 to $6 of deposits to $1 of reserve, compared with about 8 to 1 under the existing requirements, and more than 10 to 1 under those formerly in effect. All of which is well understood by the authorities and presumably will be taken into consideration in determining what steps, if any, should be taken at the present time.

The Official Attitude

Spokesmen, both for the Treasury and for the Reserve Banks, have made clear that measures such as the gold "sterilization" program, and contemplated changes in reserve requirements, are precautionary moves designed to keep excess reserves within manageable proportions and are not intended to tighten money. While it will be granted that neither the Treasury nor the Reserve Banks have power to keep money rates down indefinitely, it would appear that the monetary authorities still have command of the situation. Expanding business needs, of course, will steadily require more money, but so large is the supply of available funds that it would take a long time for business to run out of credit fuel if the situation is merely left alone, to say nothing of additional supplies of credit that might be injected into the market.

Sooner or later, however, the controlling agencies will have to choose between mopping up excess reserves and permitting money to tighten or letting inflation get out of hand. Thus, in the end, the question of money rates comes back to credit policy. For those closely concerned with money conditions, this suggests the desirability of being on the watch for signs and symptoms of a kind likely to call forth restrictive action. As a general rule, the tendency wherever monetary control is exercised is to overdo the cheap money business, and to delay rather than hasten the time of going into reverse.

Budget Balance Essential to Credit Control

That budgetary equilibrium is an essential pre-requisite of any program of controlling inflation has been said so often in these columns and elsewhere that no doubt our readers are tired of hearing it; yet this fact is so important that it justifies frequent reiteration. So long as the budget is unbalanced the ability of the Reserve Banks to effectively control credit will be seriously handicapped. This is true for two reasons:

First, because an unbalanced budget is an obstacle to free decisions on credit policy. As the success of a borrowing program is dependent upon cheap money, therefore, so long as the Treasury has to raise new loans, the Reserve Banks will be in a difficult position to take any action that would tighten money, especially if such action should involve a sale of Government securities.

The second reason is because deficit financing is itself an inflationary process. When the Treasury borrows from the banks, the effect is to create new bank deposits, which, when

checked out by the Government, flow into the accounts of individuals, businesses and institutions in all parts of the country, increasing the circulating medium. Of what purpose is it to attempt to control inflation through central bank action unless the Federal Government halts the flow of new deposits created through bank borrowing?

For the past three years, Government borrowing and spending, together with gold imports, have been almost wholly responsible for the growth of bank deposits. As those in the banking business well know, ordinary loans to industry and trade have had little to do with the increase. Already the total volume of deposits exceeds the levels of 1929. While it is true that at present these deposits are relatively inactive, and therefore have not yet had their full effect upon business and prices, this will not always be the case. However, if there is danger in the situation, it lies, as the figures clearly show, not in the borrowings of private business, but in continuing borrowings by the Government.

In a recent address before New England business men, Chairman Eccles of the Federal Reserve Board expressed apprehension over the inflationary possibilities inherent in the existing large total of bank deposits, and emphasized the importance of bringing the budget to an early balance as part of the program to control expansion. He defended the Government's borrowing policy during the depression as necessary to bring about "reflation", but stated that "we have now reached the stage in recovery at which it is no longer desirable to have additions either to our banking reserves or substantially to the volume of deposits."

Commenting further on the situation, Chairman Eccles expressed the view that retirement of public debt out of taxes would be "one of the greatest factors in stopping inflation" because it would tend to offset private credit expansion. We quote as follows:

> In times of full business activity, Federal revenue, which is one of the greatest factors in stopping inflation, should greatly exceed Federal expenses. At such times, Federal revenue should be diverted to the reduction of the Federal debt. This in turn has the effect of offsetting private credit expansion by the banking system as recovery proceeds and thus of keeping the supply of money more or less constant.

For these and other reasons, it is encouraging to have the Administration's more favorable view of the budget prospects, as expressed in the budget message recently submitted to Congress. A further discussion of the fiscal position of the Government, as revealed by the budget proposals, appears in a following article on "The State of Federal Finances".

Effect of Decreased Government Borrowing

If, as now appears probable, the rapidly swelling governmental revenues, together with large cash balances on hand and the investment requirements of the Social Security Fund, should result in a substantial reduction in the volume of Government loans (other than refinancing) floated in the open market, the effect may be to slow down the rate of credit expansion compared with that of the last three years. This possibility is of interest to bankers from the standpoint of growth of deposits, but it has also a broader significance in that a retardation of the growth of credit would tend to exert a tempering influence upon business and speculation; which might be a good thing. Business is unquestionably better off, and the chances of lasting stability improved, by occasional periods of testing which reveal weaknesses in the structure before they become serious, and hold oversanguine expectations in check.

Of course, the trend of total credit will be influenced by the extent to which private borrowing picks up. For the past year private credit demand has been increasing and may be expected to continue upward with the expansion of business. Moreover, this tendency should be accelerated by a falling off in Government borrowing. One reason for the failure thus far of private credit demand to reflect more fully the increase of business has been the huge quantity of credit created and put into circulation by the Government. This "money" has been used in some instances to repay bank loans, and directly or indirectly has financed a vast amount of "cash" buying, both of goods and of securities. While there has been an appearance of business and stock market recovery without use of bank credit, actually the credit has been there in the form of bank deposits, created originally by Government borrowing (and gold imports). Therefore, if from now on the Government borrows less, there is reason to believe that business and private operators will borrow more.

Recent Changes in Bank Credit

The seasonal return of holiday currency to the banks between December 23 and January 27 totaled $362,000,000—greater than last year, but less than had been expected on the basis of the average seasonal movement. Ever since 1933 there has been an upward trend in the circulation of money, and the total of $6,318,000,000 outstanding on January 27 was $625,000,000 higher than a year ago. Excess reserves of the member banks increased during the month, but did not recover fully the loss caused during December by currency withdrawals and governmental tax and financing operations.

When the further raising of reserve requirements was first discussed, last November, the general impression was that excess reserves, by the first of February, would be in the neigh-

borhood of $2,400,000,000, whereas the actual excess on January 27 was estimated to be only $2,150,000,000. This failure of reserves to reach the expected level was due not only to the less-than-seasonal return of currency, but to the fact that the Treasury has maintained a fairly high deposit ($180,000,000) in the Reserve Banks and has drawn substantially upon its balances with member banks in connection with regular governmental expenditures and purchases of imported gold, the latter to be "sterilized" by segregation in an inactive account instead of being made the basis of gold certificate issues to the Reserve Banks, as was the practice in the past. Since the inauguration of this new policy with respect to the acquisition of gold, on December 24, the accumulation in this inactive account up to January 26 reached $110,000,000.

During the first three weeks of January there was a reduction of $266,000,000 in total loans of the weekly reporting member banks, of which $116,000,000 was in loans secured by stocks and bonds and $150,000,000 in other loans. The recent reduction in the latter classification is understood to have been caused in part by the payment of substantial loans made by banks last Summer to the Commodity Credit Corporation against grain and cotton. Notwithstanding the month's reduction, the present total of bank loans outstanding, other than those secured by stocks and bonds, amounting to $5,713,000,000 on January 20, was $807,000,000 above the level of a year ago. Loans against securities, totaling $3,210,000,000, had increased by only $43,000,000 during the year, despite the increase in stock market activity, the rise in stock and bond prices and increased offerings of new securities. Bank holdings of United States Government and other investments have shown little change since the first of the year, following a reduction since last July.

Changes in the Bond Market

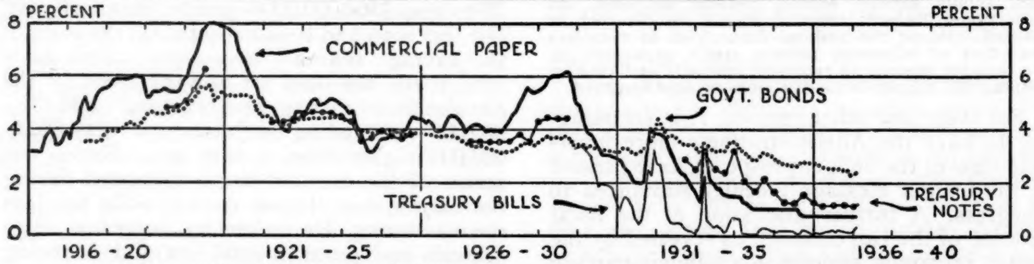
The weakness in the bond market, already referred to as reflecting the uncertainty as to governmental action on reserve requirements, has affected principally the high-grade issues, which normally sell on the basis of money rates, rather than the medium and low-grade issues, which sell on the basis of speculative risks, corporate earnings, etc. In the Government market, the long-term Treasury bonds declined somewhat less than did the shorter-term Treasury notes. The relatively small yields on the low-coupon maturities of five years or less have made them vulnerable to any change in short-term money rates. A readjustment toward narrowing the spread between yields on the representative long and short-term Treasury issues may be seen from the following table giving the current prices and yields as compared with the 1936-1937 highs:

United States Treasury Bonds and 3-5 Year Treasury Notes

Bonds	1936-1937 High Price*	Jan. 28 1937 Price*	Change From High*	Yield to Maturity At High	Yield to Maturity Jan. 28 1937
3s of 1955/51	106.28	106.22	—0.6	2.44	2.54
2 ⅞s of 1960/55....	104.26	104.16	—0.10	2.54	2.62
2 ¾s of 1951/48....	104.18	104.8	—0.10	2.28	2.39
2 ¾s of 1954/51....	103.16	103.12	—0.4	2.46	2.51
2 ¾s of 1959/56....	103.9	103.8	—0.1	2.54	2.56
2 ½s of 1953/49....	101.21	101.14	—0.7	2.37	2.38
Average........			—0.6	2.44	2.50
Notes					
1 ⅝s of 3-15-40....	102.12	101.19	—0.25	0.87	1.09
1 ½s of 6-15-40....	102.2	101.5	—0.29	0.89	1.14
1 ½s of 12-15-40..	102.2	101.5	—0.29	0.96	1.18
1 ½s of 3-15-41....	102.3	101.5	—0.30	0.99	1.20
1 ⅜s of 6-15-41....	101.21	100.23	—0.30	1.00	1.20
1 ¼s of 12-15-41..	101.3	100.8	—0.27	1.03	1.19
Average........			—0.28	0.96	1.17

* Figures after decimals are 32ds.

It will be noted that whereas the six representative bonds declined an average of 6/32ds of one point from their highs, the six notes (including the new 1¼s that have been outstanding only since December 15) declined an average of 28/32ds of one point. At the highest prices, the disparity between average yields on the bonds and notes was 1.48 per



Average Interest Yield on United States Government Securities and Commercial Paper

Notes: Treasury bond index is based upon average of all outstanding bonds, except those due or callable within eight years. Treasury note index is based upon quarterly quotations of all outstanding notes having maturity of 3 to 5 years; it includes such bonds as come within this maturity, but excludes special notes issued directly to trust funds; breaks in the index indicate that no issues of the 3-5 year maturity were outstanding during those periods. Treasury bill index is based upon annual rate of discount at which issues of various maturities were sold. Commercial paper index is the average open market rate on 4-6 months choice names.

cent, while this margin has now been narrowed to 1.33 per cent.

In the diagram on page 20, we give a comparison of interest rates on Government obligations of different maturities, and on commercial paper, over a nineteen-year period, or since the flotation of the First Liberty Loan in June, 1917. Here we see illustrated the tendency for the shorter-term rates to swing more widely than the longer-term rates, going higher in times of monetary stringency and falling lower in times of monetary ease. These "spreads", first in one direction and then in the other, were characteristic of the entire period covered in the diagram, but have been particularly marked in the period since 1933-34, owing to the virtual collapse of short-term rates under pressure of surplus funds and investor demand for investments of maximum liquidity. With short-term money currently as far out of line as the diagram indicates, it is evident that any readjustment of rates naturally would appear first in this field, probably with relatively little effect upon the long-term rate in the early stages.

New Offerings

New bond offerings, largely for refunding purposes, continued large during the month and were well received, particularly in view of the irregularity that prevailed in the market for outstanding prime issues.

Evidence of further recovery in foreign financing, other than Canadian, is the filing for registration by the Kingdom of Norway of a new issue of $29,000,000 in 4s of 1963, to be offered early in February for the purpose of refunding its outstanding 5s of 1963, which will be called for redemption. The progressive lowering of interest rates is shown by comparison with its two previous issues, which were $17,000,000 in 4½s in March, 1936, to refund outstanding 6s, and $31,500,000 in 4¼s in April, 1936, to refund 5½s. Last March the City of Oslo, Norway, also sold an issue of 4½s to refund 6s.

The Republic of Argentina, which last November sold an issue of 4½s for the purpose of refunding 6s, and later retired another issue of 6s out of cash, carried forward another step in its program of debt refunding and retirement when it announced in January that it would redeem two additional issues in cash through sinking funds, the $16,000,000 in 5½s of 1962 and $22,000,000 in 6s of February 1, 1961. The Argentine 4½s offered last Fall at 92½ have advanced to around 100, which price provides a striking contrast with the markets of a few years ago.

There are, of course, limitations to the further expansion of foreign government financing in the American market in the near future, inasmuch as many of the other countries have not yet recovered economically and financially to the point where refunding is practicable, or because their high-coupon bonds still outstanding are not callable for redemption prior to maturity. Moreover, the Johnson Act automatically bars new offerings for the account of all the countries owing war debts to the United States, with the exception of Finland, which is not in default and which as long ago as December, 1934, sold an issue of serial 4s here for the purpose of refunding its long-term 5½s and 7s.

Extension of Emergency Powers

During the past month, Congress, acting in accord with the Administration's financial program, has authorized the extension for a further limited period of certain emergency legislation dealing with currency and credit, enacted originally during the depression and expiring within the month or shortly afterwards. We do not have space for a full discussion of this legislation, but a brief summary may be of interest.

Following are powers having to do with the currency which have been extended to June 30, 1939:

1. Authority of the President to change the gold value of the dollar within the limits provided by law; that is, between 50 and 60 per cent of its former value. (Would have expired January 30, 1937).
2. Authority to continue the stabilization fund. (Would have expired January 30, 1937).

Still pending in Congress is a bill covering the following:

Extension to June 30, 1939 of the authority of the Federal Reserve Banks to use United States Government securities as collateral security for Federal Reserve notes (now due to expire March 3, 1937).

In extending the power to devalue the dollar and in prolonging the life of the stabilization fund, Congress has taken cognizance of currency uncertainties still existing throughout the world. While the Government appears justified, under the conditions, in seeking a renewal of these powers, those at least having to do with a change in the value of the currency should be availed of under none but the most exigent circumstances.

For the three years that have elapsed since the revaluation of the dollar on January 31, 1934, the United States has enjoyed a de facto, if not a de jure, stabilization of its currency in terms of gold. During this period confidence in the dollar has increased immeasurably and has given powerful support to the other forces making for recovery. In the field of international currency stabilization, an event of great promise has recently taken place—the tripartite currency understanding—to which the United States has been a party, and which has raised great hopes that the world is emerging at last from the chaos and confusion resulting from unstable exchanges. Without attempting to pass judgment on the original act of dollar devaluation, it can be agreed that the United

States has taken a position of leadership in recent years in maintaining a fixed base for its currency ahead of most other countries. Because of its great economic and financial power, it is of paramount importance that this country should continue to exert its influence constructively and in a manner to promote currency stability, without which world trade will be seriously handicapped.

With a continuance of the power to use Government securities as collateral security for Federal Reserve notes, the danger of a possible shortage of collateral resulting from an outflow of gold would be avoided. At present, the Reserve Banks hold practically no "eligible paper", owing to the virtual absence of member bank rediscounting—hence are dependent upon the use of gold certificates and Government securities for collateral purposes. While for the System as a whole, the quantity of gold certificates now held is adequate, this is not true for all individual Reserve Banks, and it might not be true for the System as a whole were gold certificates to be substantially reduced by gold exports. In the latter event, unless Government securities are available as collateral, the Reserve Banks might be forced to contract credit at a time when, possibly, they should be expanding credit to offset gold exports.

Extension of Credit Agencies

In January, Congress likewise extended to June 30, 1939, the life of the Reconstruction Finance Corporation, together with its affiliated agencies, — the Commodity Credit Corporation, the Electric Home and Farm Authority, the Export-Import Banks and the R. F. C. Mortgage Company. In a letter to Congress reviewing the activities of the R. F. C., the Chairman, Mr. Jesse H. Jones, stated that the total disbursements had been $6,344,413,566.45, of which $4,374,347,801.83, or 60 per cent, has been repaid, leaving a balance outstanding of $1,970,065,764.62. He further stated that "we are liquidating as rapidly as is consistent with the best interests of our borrowers, and the best interest of the country."

The Japanese Economic Situation

The economic situation in Japan has become a subject of general discussion during the past month, due to a series of important developments accompanied, in the early part of the month, by a temporary weakening in the yen exchange rate. The first of these developments was the establishment of new and more stringent exchange regulations governing payment for imports, the purpose of which was of course to give the yen the support temporarily needed. The second was the introduction of the 1937-38 budget, carrying a deficit in the general account despite increased taxation, of 800,000,000 yen to be covered by new loans. This led to a vigorous debate in the Imperial Diet, culminating in a political crisis and the resignation of the Hirota Cabinet on the 23rd. The yen, which has been held at an approximately fixed rate with sterling equivalent to about 28.60 cents with sterling at $4.90, weakened at the beginning of January to 28.25 cents, from which point it rallied to the previous rate as the control measures took effect.

These developments have been viewed with some concern in other countries, coming at a time when trade and currency restrictions are gradually being lightened in many countries, and when the earnest hope of all business men is that the trend will continue in that direction. Moreover, they are of special interest in the United States, in view of the important position which Japan occupies in our foreign trade. In recent years the Island Empire has been our third best customer, ranking after Great Britain and Canada, as well as the third largest source of our imports.

Fortunately, the nature of the regulations implies that they will not drastically restrict trade, and American businessmen generally will view them with sympathetic understanding of Japan's difficulties. As between the alternatives of exchange control and an unstable and depreciating yen it is certain that the former is less disturbing to orderly trade. The exchange control is declared to be temporary, expiring at the end of July, and a wide latitude is evidently to be permitted in its administration. In principle a permit will be required from the Ministry of Finance for any individual foreign exchange transaction exceeding 10,000 yen, or in case of letters of credit for more than 30,000 yen a month. Since the measure has not been made retroactive, outstanding contracts and letters of credit are not affected by this ruling.

Reasons for Exchange Control

It has been known for some time that the payments Japan is called upon to make on international accounts were running close on the heels of the payments received by her, despite the unprecedented expansion in exports. The trade balance last year was the most unfavorable since 1929, and capital investments in Manchukuo have also absorbed foreign exchange. Moreover, from now on through the Spring, Japan normally has her largest import balances; also, according to reports from Japan, heavy purchases of raw materials, particularly of pig iron, are impending as a result of the rearmament program and exceptionally high industrial activity, which is now at an all time record level. Tariff increases to take effect in April may also be causing a temporary increase in buying.

The cost of Japanese imports has risen sharply. As may be observed from the table below, an index of prices of imported goods at the end of last October was over 120 per cent higher than in December, 1931, when the country left the gold standard, whereas export prices advanced during the same period only about 47 per cent. The rise since the first of November in the international prices of basic industrial materials had made this relationship still more unfavorable. Undoubtedly it is one of the chief causes requiring stricter conservation of exchange for the time being.

The rise in world prices is also causing domestic prices to advance. To what extent the cost of living, and in turn wage rates, will be affected in the future remains to be seen. Japanese wage rates in general have declined since 1932, as will be seen from the index in the table, which measures wage rates of factory labor in a considerable number of industries. This index is off almost 10 per cent since 1932. The decline in wage rates has been one of several factors enabling Japanese exporters to compete with increasing success in foreign markets, and to expand their trade during the worst years of depression. Two other important factors in increasing exports have been the improvement in her manufacturing efficiency, and of course the depreciation of the yen to about one-third of its 1930 parity.

Still another source of the present exchange difficulties may be found in the state of the Japanese Government finances. New and heavier taxes will be imposed during the coming fiscal year, but even so ordinary revenues will cover only about two-thirds of total expenditures, which have more than doubled since 1931. The deficit will be met from internal borrowing which will again raise the national debt, now over 10 billion yen. The extent to which this rise has been due to military expenditures may be noted from the table. The mounting Government debt naturally tends to excite inflationary fears, which according to the experience of other countries usually leads to speculative buying of commodities and the export of capital.

The subjoined table summarizes the pertinent figures which show the trends in the economic situation.

The State of Federal Finances

President Roosevelt's budget message to Congress reviews the national finances during the four years of his first administration, and makes a confident forecast for the future. He predicts that the public debt will reach its peak figures at the end of this fiscal period, June 30 next, and that revenues will equal expenditures in the following year, provided Congress keeps its appropriations within the limit of his proposals. Later on he looks for debt reductions.

The President naturally is gratified by the improvement in the national finances and in private business that have come during his administration. Summing up the gains in a brief paragraph he says:

> Business conditions have shown each year since 1933 a marked improvement over the preceding year. Employment in private industry is increasing. Industrial production, factory pay rolls, and farm prices have steadily risen.

This statement is supported by the record, and everybody rejoices over the gains that have been made since 1932, the low year of the depression. Opinions differ as to what caused the depression and which of the numerous influences making for recovery has been most important. The President has stated his views

Trend of Japanese Business, Prices and Government Finances

(All value figures in millions of yen)

Calendar Years	Yen % of Gold Parity	Mdse. Expts. Value	Mdse. Impts. Value	Mdse. Trade Bal.	Export Prices	Import Prices	Wholesale Prices	Living Cost	Wage Rate	Ind'l Prod'n	Bank Deposits**	Fiscal Years	Budget Expend. Army & Navy	Budget Expend. Total	Loans Raised‡	Govt. Bond Debt.
1929	93	2,101	2,169	— 68	......	......	100	100	100	100	14,035	1929-30	506	1,736	128	5,959
1930	99	1,431	1,507	— 76	......	......	82	86	98	95	13,841	1930-31	442	1,558	....	5,955
1931	98	1,118	1,206	— 88	100*	100*	70	75	93	92	13,859	1931-32	454	1,489	214	6,187
1932	56	1,362	1,383	— 21	159	171	73	75	90	98	14,681	1932-33	686	1,950	781	7,054
1933	40	1,827	1,883	— 56	130	171	82	80	86	113	15,489	1933-34	871	2,255	846	8,139
1934	36	2,134	2,244	—110	135	187	81	82	84	129	16,423	1934-35	942	2,163	830	9,090
1935	34	2,453	2,426	+ 27	140	202	84	84	82	142	....	1935-36	1,032	2,206	761	9,854
1936	35	2,797	2,928	—131	......	......	....	....	......	......	....	....	....	....	....	....
1936																
June	35	203	224	— 21	133	203	88	87	82	147	17,024	1936-37†	1,058	2,311	787	10,307e
July	35	218	199	+ 19	140	213	90	87	82	151	17,004	1937-38†	1,409	3,041	961	....
Aug.	35	225	187	+ 38	141	214	91	88	81	151	17,093	....	....	....	....	....
Sept.	35	238	184	+ 54	143	218	91	88	82	......	17,296	....	....	....	....	....
Oct.	34	257	197	+ 60	147	221	91	88	82	......	17,248	....	....	....	....	....
Nov.	34	247	231	+ 16	......	......	93	88	......	......	....	....	....	....	....	....
Dec.	34	279	319	— 40	......	......	98	....	......	......	....	....	....	....	....	....

*—December 10, 1931 = 100; figures as of the end of the years and months.
**—Deposits in commercial banks, savings banks, postal saving bank and the Special Chartered Bank.
†—Budget estimates. ‡—Includes loans raised both for the general account and for special accounts such as telegraphs, railways and the Korean Government.
e—Estimated.

frankly but temperately in his three messages to Congress in the past month, and again in his inaugural address; others, differing in some respects, are disposed to say that in 1932 the state of Government finance and of private business was much the same in all parts of the world, and that the gains since then have extended to all countries. However, all are agreed that recovery is on the way, and this may be taken as evidence that the disorders in the economic system were of a temporary character, probably originating outside of the system itself. Such disorders have followed all wars, and the World War was the most disturbing of all.

In the second paragraph of his budget message, the President describes the objectives of his administration as follows:

> The fiscal plans of the Federal Government for these four years have been formulated with two objectives in mind. Our first was to restore a successful economic life to the country, by providing greater employment and purchasing power for the people, by stimulating a *more balanced use of our productive capacity*, and by increasing the national income and distributing it on a wider base of prosperity. Our second was to gain new advantages of permanent value for the American people. Both of these objectives can be accomplished under a sound financial policy. (*Italics are ours.*)

The "objectives" named by the President were and are desirable. No one would oppose them as objectives; no one raises any question except as to the policies or methods that may be adopted to attain them. By far the most important one is that of obtaining *"more balanced use of our productive capacity."* If that is accomplished, all of the other objectives will naturally be attained.

These preliminary comments are believed to be appropriate to a consideration of the broad subject of governmental policies, and especially to a review of the Government's finances, which is the principal purpose of this discussion.

Effects of the War Upon the Federal Budget and Debt

Before examining the details of the financial statement, which is the basis of the hopeful forecast, it will be well to review the effects of the War upon the finances of the United States Government. We give herewith the figures for total revenues and expenditures in each fiscal year (ended June 30) from 1914 to 1936, and for the gross Federal debt at the end of each year. The years are spaced into four periods: the first covering the three years before the United States entered the War, the second, the years from our entrance to the peak of the war-boom activity in 1920, when the collapse began; the third, the post-war boom from 1922 to 1929; the fourth, the depression years to the fiscal year 1936; together with the official estimates for the present incomplete year and the fiscal year 1938.

Condensed Summary of United States Government Finances, 1914-1938

(In Millions of Dollars)

Year. Ended June 30	Total Government Revenues	Total Government Expenditures*	Surplus or Deficit*	Gross Debt (A) June 30
1914	$ 735	$ 735	$	$ 1,188
1915	698	761	—63	1,191
1916	783	734	+48	1,225
1917	1,124	1,978	—853	2,976
1918	3,665	12,698	—9,033	12,244
1919	5,152	18,523	—13,371	25,482
1920	6,695	6,482	+212	24,298
1921	5,625	5,538	+87	23,976
1922	4,109	3,795	+314	22,964
1923	4,007	3,697	+310	22,350
1924	4,012	3,507	+505	21,251
1925	3,780	3,530	+251	20,516
1926	3,963	3,585	+378	19,643
1927	4,129	3,494	+636	18,510
1928	4,042	3,644	+399	17,604
1929	4,033	3,848	+185	16,931
1930	4,178	3,994	+184	16,185
1931	3,317	4,220	—903	16,801
1932	2,121	5,274	—3,153	19,487
1933	2,238	5,307	—3,068	22,539
1934	3,116	7,105	—3,989	27,053
1935	3,800	7,376	—3,575	28,701
1936	4,116	8,880	—4,764	33,779
1937-B	5,828	8,481	—2,653	35,026
1938-C	7,294	6,158	+1,136	....

A—Direct debt only; does not include guaranteed debt of government credit agencies. B—Second revision of budget estimate, issued Jan. 8, 1937. C—Original budget estimate, issued Jan. 8, 1937, which does not include additional requirements for relief estimated at not over $1,537 millions. * Includes expenditures for statutory debt retirement through sinking fund.

It will be seen that in the three years 1914-1916 the budget was approximately in balance. The average of yearly expenditures in the three years was about $743,000,000, and from 1900 to 1913 was about $600,000,000. The gross national debt from 1900 to 1916, inclusive, averaged less than $1,200,000,000, of which less than $1,000,000,000 was bearing interest. This included the remainder of the Spanish War and Panama Canal bond issues, while the greenback currency was included as "non-interest-bearing debt."

In April, 1917, the United States entered the War, and by the end of June the Treasury had accumulated a deficit of $853,000,000. For 1918 the deficit was $9,033,000,000, and although the War ended in November, 1918, payments on War account in the fiscal year ended June 30, 1919, caused a deficit in that year of $13,371,000,000. However, in 1920 the Treasury was back in the black, by $212,000,000, and thereafter had a revenue balance in every year to 1931, when the loss of revenues caused by the depression started the series of deficits that has continued until now.

Of course, it was only by much additional taxation that the revenues were increased as they were after 1917, and the revenues were supplemented by heavy borrowings. The peak of the debt occurred in August, 1919, at over 26½ billions, and from this by constant reductions it declined to $16,185,000,000 in 1930.

The taxation was heavy but there was satisfaction in knowing that the debt was being paid off. The depression reversed the trend. In 1913 the per capita debt was approximately $12; by 1919 it had risen to $240; in 1930 it was down to $131, and on the basis of the President's estimate will be about $270 on June 30 next. This is for every man, woman and child in the country, and no one need think that the economic law will not distribute the burden to *every one*, in proportion to his income, large or small.

These figures afford a striking contrast between the costs of the Federal Government before the War and now, although the War has been over for eighteen years. It is pertinent to add that State and local governments have increased expenditures in like manner, and that the figures are not completely comparable, because the War-caused rise of prices and wages all around the circle must be taken into account. Nevertheless, the figures serve to illustrate the characteristic "prosperity" derived from monetary inflation. If there had been no War, a sum equal to the increase of expenditures, plus other wastes and losses, might have been gained as additions to Capital, with a corresponding increase of the per capita income, *instead of the per capita debt.*

Table Submitted by the President

We come now to the table of actual and estimated expenditures submitted by the President, which is reprinted below and to which we have added a corresponding column for the last pre-war year, ended June 30, 1914.

This table shows actual expenditures by principal classes in the fiscal years 1932 to 1936, and as estimated officially for 1937 and 1938, except as modified by the foot-notes, and plus the column for 1914.

The first group is officially classified as "regular operating expenditures," which means that it includes the ordinary costs of the established departments of the Federal Government. Indeed, after the first item, which has more than trebled since 1914, nearly all are war items, including interest, or belong in what has been called "Recovery and Relief." "Public Works" in a small way has been a "regular" item, but has grown so large that it now has an independent status. Probably a major portion of this has been prompted by the "relief" motive. Debt "retirement" now refers mainly to debt incurred for recovery and relief, hence belongs in that group. The Agricultural Adjustment program has been a recovery and relief item, although it now includes other objectives. "Loans" and "Stock subscriptions" are largely

Actual and Estimated Expenditures of the Government for the Fiscal Years 1932-1938

(Classifications include expenditures from both general and emergency funds)

From the President's Budget Message

(In Millions of Dollars)

	Estimated		Actual					
	1938	1937	1936	1935	1934	1933	1932	1914e
Regular Operating Expenditures:								
Legislative, judicial and civil	$ 772	$ 859	$ 781	$ 598	$ 572	$ 697	$ 979	$ 226
National defense	992	965	992	709	540	668	708	313
Veterans' pensions and benefits	578	1,145	2,351	607	557	863	985	173f
Interest on public debt	860	835	749	821	757	689	599	23
Total	3,201	3,804	4,793	2,736	2,426	2,918	3,270	735
Public Works	908	1,147	869	704	552	428	439	(g)
Unemployment Relief:								
Direct relief	13	107	592	1,914	716	351	—	—
Work relief (WPA and CWA)	(a)	1,400	1,264	11	805	—	—	—
Civilian Conservation Corps.	(b)	368	486	435	332	—	—	—
Total	13	1,875	2,342	2,361	1,853	351	—	—
Other Outlays:								
Loans (net)	153c	420c	175c	80	789	874	404	—
Subscriptions to stock	17	51	69	157	826	111	627	—
Agricultural adjustment program	482	468	543	743	290	—	—	—
Less revenues	—	—	77	521	353	—	—	—
Net	482	468	466	222	63d	—	—	—
Social security	836	400	28	—	—	—	—	—
Debt retirement	402	404	403	574	360	462	413	—
Miscellaneous	2	2	7	21	9	—	—	—
Supplemental items	450	750	—	—	—	—	—	—
Grand Total	6,158a	8,481	8,803	6,854	6,752	5,143	5,154	735

a—To be increased by any amount appropriated by Congress for recovery and relief for the fiscal year 1938. As indicated in the message it is hoped that the amount will not exceed $1,537,123,000. b—Funds for continuation of the Civilian Conservation Corps are included under "supplemental items." c—Excess of credits, deduct. d—Excess of revenues, deduct. e—Added from 1914 Annual Report of Secretary of the Treasury. f—Item "For pensions" in 1914 report. g—Included under "Legislative, judicial and civil establishments."

recovery and relief funds, and a foot-note says of the former that in the last three years collections have exceeded new loans, and have been deducted from the aggregates, as shown by the "net." More about this further on. "Social Security" is now a "regular" item, of the relief class.

Disquieting Features of the Table

The most disquieting feature of the table is the persistence of the "recovery and relief" totals in comparison with "regular operating expenditures," and along with the steady rise of the public debt since 1930 (see first table), notwithstanding the improvement in business and employment. On June 30, 1937, the debt, according to the official estimate, will be approximately $35,000,000,000, against $16,185,000,000 on that date, 1930, or an increase of $19,815,000,000 in seven years, of which five have been years of business recovery.

All reports agree that employment in private industry has been increasing for several years. The President refers to it, as quoted above, and again in his message of January 11, says that "at the beginning of the present winter not less than 6,000,000 more workers were employed in non-agricultural jobs than in March, 1933, and of this number more than 1,000,000 have found jobs with private industry during the past year."

Secretary Roper, of the Department of Commerce, in his recent annual report, says:

> The marked improvement in conditions which has characterized the two preceding fiscal years continued to gain throughout the year 1935-1936. Economic recovery broadened this year with acceleration of activity in the durable goods industries and in construction lines, a further rise in farm income, increase in the number of persons employed and expansion in industrial payrolls.

The President counts upon a reduction of these expenditures, but for budget balancing apparently relies mainly upon increasing revenues. He admonishes Congress to keep appropriations within the estimates submitted, but strongly intimates that relief expenditures may be maintained. There is general agreement that American families "shall not be allowed to starve," but many people believe that relief expenditures may be properly reduced as employment in all fields increases; and, furthermore, that if the tax levies directed to recovery and relief were left in the coffers of private business the assurance of increased private employment would be greatly strengthened.

Another unsatisfactory feature of the table is the tendency to shift what originally were relief or emergency expenditures to more or less "regular" expenditures, or to new names suggesting "recovery" or "development" rather than "relief." This indicates that such disbursements may become permanent charges on the national budget. In 1935 the Federal Emergency Relief Administration was the principal Federal agency for financing relief, and in that year, $1,914,000,000, was disbursed for direct relief; but while in 1936 the expenditure for direct relief declined to $592,000,000, the new "Works Progress Administration" expended $1,264,000,000 for "work relief," and its expenditures for 1937 are estimated at $1,400,000,000.

It may be that the present organization is making more useful expenditures than the former one, but with industry reviving, there is a serious question whether any such agency can be usefully employed. Governments do not have the reputation of carrying on industrial enterprises more efficiently or economically than they are usually conducted under private management. This question involves radically different opinions of the proper functions of government.

It is a noteworthy fact in this connection that the Interstate Commerce Commission, an agency of the Federal Government, has recently denied the railroads any further extension of the emergency increases in freight rates after December 31, 1936, citing the expanding national recovery and declaring that the conditions which led to the authorization of the emergency charges no longer exist.

Disposition of Recoveries on Loans

Especial interest attaches to the practice of reporting collections of the lending agencies, particularly the R.F.C., in a manner which may seem to reduce the disbursements of the spending agencies. In 1932, 1933, 1934 and 1935 the operations of the former agencies were expanding, loans exceeding collections, but in 1936 collections exceeded loans by $175,000,000; in 1937 by an estimated $420,000,000, and in 1938 by an estimated $153,000,000, but the Treasury report, instead of showing complete transactions, has handled the net reduction of loans in a way that reduces the total of all outlays. (See table.) While it is true that the aggregate deficit is not affected, nevertheless the practice is misleading in that the relief expenditures are obscured by the loan collections; whereas the public should be kept informed as to the actual amount of these expenditures.

Balancing the Budget

There is, of course, no reason to doubt that the President wants to balance the budget, and expects it to be balanced as indicated, but many loyal and well-informed supporters of his administration have grave misgivings about the realization of his expectations. They frankly express the opinion that to separate 3,000,000 persons from payrolls to which they have been attached for years is a formidable undertaking, particularly as they are members of an organization that has developed a sense

of political power. These friends of his know the pressure upon Congressmen from the "folks" back home, even at the expense of the National Treasury. They know that the ramifications of the "relief" organizations extend throughout the country, and that the "relief" propaganda has the support of local interests. The latter like the easy flow of good things from Washington, D. C., and the friends say that nothing but grim and hard-fisted determination ever will balance the budget again.

There is something ominous about these warnings, because there are ominous facts to support them, as, for example, the Florida Ship Canal and "Quoddy" projects, etc., and even more serious, a widespread feeling that, after all, most of the Federal taxation falls upon corporations and rich people, and that no one else is concerned. It is no exaggeration to say that not many people understand that an increasing supply of wealth productively employed benefits the entire consuming public.

Drain on the National Income

The text of the President's special message of January 11, contains a passage that is highly suggestive, and the more so because he has said it twice. He quotes from another special message to Congress, on the same subject, dated March 18, 1936, as follows:

> The ultimate cost of the Federal works program will thus be determined by private enterprise. Federal assistance which arose as a result of industrial disemployment can be terminated if industry itself removes the underlying conditions. Should industry cooperatively achieve the goal of reemployment, the appropriation of $1,500,000,000, together with the unexpended balances of previous appropriations, will suffice to carry the Federal works program through the fiscal year 1937. Only if industry fails to reduce substantially the number of those now out of work will another appropriation and further plans and policies be necessary.

It is quite safe to assume that every industrial employer is eager to increase his working force, if he can do so with a margin of return over costs. He naturally wants to employ his productive facilities to the limit, but if he does so at a loss he will soon be out of business, in which case the President's appeal obviously will be fruitless. It should be kept in mind that the calendar year 1936 has been the first one since 1929 in which the business organization of this country, as a whole, has not had losses exceeding gains. Reserves have been depleted and thousands of individual business houses have become bankrupt. Modern business cannot carry on without capital, nor can the present standard of living for the population be maintained without the employment of capital in production; and the chief source of capital replenishment and additions always has been the net earnings of the industries.

Many of the sincere friends of the President are disturbed because his plans for balancing the budget appear to rest mainly upon an expectation of continually increasing revenues. They point out that if the budget was balanced now by revenues alone, without borrowing, the present volume of expenditures would require revenues twice as large as were received in the year of the last balanced budget, which was the fiscal year ended June 30, 1930. Evidently a much larger share of the national income would be taken by taxation than at any time in the past. To carry such a burden, the nation must produce more wealth than ever before. It means that the people must live or spend more closely, work harder, or that the capital equipment of the industries must be increasingly productive.

The proprietors of industry are eager to accomplish the latter, but cannot do it alone. It will require balanced, harmonious and cooperative relations throughout the economic system. Enterprise must be stimulated and courage strengthened. In the last seven years a great part of the industrial equipment has become obsolete, and should be replaced. This has been illustrated in the past month by the estimates of the Iron and Steel Institute for improvements in the steel industry, which now aggregate $290,000,000 for 1937, against $200,000,000 estimated a year ago for 1936, and not in years has the outlook for constructional work, including tools and machinery, been as good as now, provided capital can be had on favorable terms. Such expenditures point the way to complete employment and an end of "relief" expenditures. It is safe to say that 95 per cent of such capital expenditures will be distributed to wage-workers either directly or by the purchase of equipment and materials, and also that the improvements when completed will reduce the living costs of all wage-workers, for this is the history of industrial progress.

This situation is directly related to the Federal Government's policy of penalizing the use of industrial earnings for industrial development. It is well known that managers and proprietors of industries, as a rule, instead of paying dividends, prefer to finance improvements by using net earnings, rather than by the alternative methods of going into debt or taking in new partners, even if the latter be practicable. Moreover, who can doubt that the former is the safe and sound policy for the industries and for orderly social progress.

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